

**LEGISLATIVE SERVICES AGENCY  
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House  
(317) 232-9855

**FISCAL IMPACT STATEMENT**

**LS 8139**

**BILL NUMBER:** HB 1899

**DATE PREPARED:** Mar 26, 1999

**BILL AMENDED:** Mar 25, 1999

**SUBJECT:** Insurance Premiums Tax rate reduction.

**FISCAL ANALYST:** Brian Tabor

**PHONE NUMBER:** 232-9855

**FUNDS AFFECTED:** X **GENERAL**  
**DEDICATED**  
**FEDERAL**

**IMPACT:** State

**Summary of Legislation:** (Amended) This bill reduces the insurance premium tax from 2% to 1.3% over a five year phase-in period.

**Effective Date:** (Amended) January 1, 2000.

**Explanation of State Expenditures:** (Revised) The Department of Revenue and the Department of Insurance will incur some administrative expenses associated with changing tax forms, instructions, and computer programming.

**Explanation of State Revenues:** (Revised) The Insurance Premium Tax is assessed on gross premiums received on policies covering risks in the state of Indiana. The tax base is comprised of premiums written or renewed in the past year minus deductions of reinsurance premiums, dividends paid to resident insureds, and premiums returned. The tax rate is currently 2.0% of these net premiums. The tax is paid by all insurance companies doing business in Indiana, however, companies domiciled in Indiana may elect to pay the Corporate Gross Income Tax in lieu of the Premium Tax (domestic firms also must pay the Supplemental Net Income Tax, or SNIT). Revenue from the Premium Tax is deposited in the state General Fund.

Reducing the Premium Tax rate could affect revenues from the Insurance Premium Tax, the Gross Income Tax, and the SNIT as follows:

*Insurance Premium Tax:* A reduction in the Insurance Premium Tax rate may affect domestic insurance companies differently than out-of-state entities:

(1) *Effect on domestic companies:* Decreasing the Insurance Premium Tax rate by 35% would not simply reduce the amount of tax due on premiums written in Indiana by the same proportion. This is partly because domestic companies may elect to pay the Gross Income Tax in lieu of the Premium Tax. In fact, of

the more than 130 insurance companies domiciled in Indiana, only 39 currently elect to pay the Insurance Premium Tax. Only about \$4,556,000 in premium taxes were paid by Indiana domiciled insurance companies in 1997. If the Premium Tax rate is lowered, more companies may find it advantageous to pay the Premium Tax, simultaneously reducing Gross Income Tax revenue.

(2) *Effect on insurance companies not domiciled in Indiana:* The impact on out-of-state insurance companies varies with each state of domicile. This is due to Indiana's retaliatory tax provision, which provides that premiums written in Indiana by a company not domiciled in Indiana are taxed at either Indiana's rate or the rate in that company's home state, whichever is higher. The varying effects of the retaliatory provision are outlined in the following paragraphs:

(a) *Rates of 2.0% and above:* Premium Tax revenue collected from companies domiciled in states with a rate of 2.0% or higher would not change, no matter how low Indiana's rate was set. Because of the retaliatory provision, Indiana would collect at the higher of the two rates, which would still be at least 2.0%.

(b) *Rates between 2.0% and 1.3%:* Under this bill, Indiana will lose some revenue from companies in states where the Premium Tax rate is below 2.0% but above 1.3%. Connecticut, for example, has a rate of 1.75%. Under current law, the tax on premiums written by Connecticut companies in Indiana would be assessed at 2.0%. After a change in Indiana's rate to 1.3%, taxes on Connecticut premiums would be collected at 1.75%, the higher of the two rates. The retaliatory provision mitigates the potential loss with companies from states with premium tax rates between 2.0% and 1.3%,

(c) *Rates below 1.3%:* For companies domiciled in states with rates below 1.3%, the effect would be to reduce taxes paid in Indiana by 35%. The highest rate that would be applied would now be 1.3%, not 2.0%.

Although the retaliatory provision mitigates the potential loss, Premium Tax revenue from out-of-state companies would likely decrease whenever the rate is lowered. The net effect depends greatly on the number of domestic companies that switch to pay the Premium Tax rather than the Gross Income Tax. The impact of the proposed rate change on Insurance Premium Tax revenue was estimated using a model that included retaliatory tax effects. Several important assumptions were made:

- Although this bill proposes a five year phase-in by reducing the rate to 1.3% by 2004, the full 0.7% reduction was assumed to happen at once to better demonstrate the maximum impact of this proposal.
- Based on recently proposed or enacted legislation, changes in premium tax rates in neighboring states were incorporated in the model. The new rates that were applied were: 1.4% in Ohio; 1.5% in Kentucky; 1.5% in Illinois; other various reductions in Alabama, Colorado, Tennessee, and Washington DC. All other states were assumed to maintain the same rates imposed in 1997.
- The majority of Indiana domestic insurance companies do not pay the Insurance Premium Tax. If the rate was lowered, some additional companies may elect to pay this tax in lieu of the Gross Income Tax. It is not known if a 1.3% rate would be sufficient for most companies to make this transition. To present a fiscal impact range, two scenarios are presented here:

- (1) No additional companies switch from paying the Gross Income Tax; and
- (2) All domestic companies elect to pay the Premium Tax.

*Insurance Premium Tax:* In the first scenario above, the lowered Insurance Premium Tax rate (1.3% from 2.0%) results in a loss in Premium Tax revenue of about \$23,700,000. If only the domestic companies currently paying the Premium Tax are taxed at the lower rate, these firms would see their Indiana Premium Tax liability reduced by about \$1,600,000. The remaining \$22,100,000 represents both tax savings for out-of-state insurance companies and a loss of retaliatory tax revenue for Indiana.

In the second scenario, the current domestic Premium Tax payers and all foreign companies would realize the same tax savings, but as all Indiana companies switch from paying the Gross Income Tax to the Premium Tax, the total domestic Premium Tax liability is greatly increased. Despite the lower 1.3% rate, Premium Tax collections from all Indiana taxpayers would now be \$31,200,000 (compared with \$4,556,000 under the current 2.0%). Under this scenario, this \$26,600,000 increase offsets the \$22,100,000 savings for foreign companies mentioned in the paragraph above. As a result, net premium tax collections would be approximately \$4,600,000 greater (any errors are due to rounding).

As stated above, this model includes proposed or enacted changes in other states. Because some states that previously had premium tax rates (or effective premium tax rates) above 2.0% and are instituting reductions, Indiana will lose some revenue unless the present Premium Tax rate was increased. If Indiana's rate remains at 2.0%, the already proposed or enacted reductions in Alabama, Colorado, Louisiana, Ohio, and Washington DC will generate a loss of \$2,900,000 in retaliatory tax revenues to Indiana. To account for this effect, this base amount is subtracted from the impact of each scenario (see table below):

<b>Scenario</b>	<b>(1) No Gross Payers Switch</b>	<b>(2) All Pay Premium Tax</b>
Insurance Premium Tax Revenue Change	(\$23,700,000)	\$4,600,000
LESS: Loss Regardless of Change	(\$2,900,000)	(\$2,900,000)
<b>INCREMENTAL IMPACT</b>	<b>(\$20,800,000)</b>	<b>\$7,500,000</b>

*Gross Income Tax:* The Gross Income Tax is normally assessed on the total gross receipts of a corporation's transactions in Indiana. However, not all of the gross receipts of an insurance company are taxed under the Gross Income Tax. The tax rate is 1.2%, and revenue from this tax is deposited into the state General Fund.

Only 39 of the insurance companies domiciled in Indiana currently elect to pay the Insurance Premium Tax. The remaining companies pay a total of approximately \$30 M in Gross Income taxes. In the first scenario, the gross revenue would remain unchanged. However, as the premium tax is reduced, more companies may find it advantageous to pay the Premium Tax. If all companies switched to the Premium Tax, Gross Income Tax revenue would decrease by the full \$30 M.

*Supplemental Net Income Tax:* Supplemental Net Income Tax liability is specially calculated for domestic insurance companies. The tax base is the federal taxable income of the company adjusted by:

- (Step 1) Multiplying the federal taxable income by the ratio of premiums tax receipts from policies insuring persons or property in Indiana to total premiums receipts; and
- (Step 2) subtracting the company's Gross Income Tax liability or the gross premiums tax liability, depending on which one the company has elected to pay.

The adjusted tax base as calculated above would then be multiplied by the SNIT rate of 4.5% to determine tax liability. SNIT revenue is deposited in the state General Fund.

If an insurance company switched from paying the Premium Tax or Gross Income Tax to the other because the taxes due would be less, the amount that would be subtracted in Step 2 would be smaller, resulting in greater SNIT liability. The DOR estimates that between \$5 M and \$8 M in SNIT is paid annually by domestic life and property and casualty insurance companies. This amount appears to vary annually due to the effects of filing consolidated returns and tax credits claimed by these companies.

If Indiana domiciled insurance companies continue to pay the same tax (either the Gross Income Tax or the Insurance Premium Tax) as they elected to pay in 1997, a reduction in the Premium Tax rate to 1.3% would generate \$1,600,000 in tax savings for the Premium Tax payers. These companies would not be able to deduct this net gain from their adjusted tax base (see Step 2 above), resulting in an annual state increase of \$72,000 in SNIT revenue (\$1,600,000 x 4.5%). Gross Income Tax payers' SNIT liability would be unaffected under this scenario.

Assuming that all companies switch to paying the Premium Tax, SNIT collections would then be affected by the net gain of insurance companies. According to the model, the companies choosing to switch taxes would pay \$26,600,000 in additional premium taxes, but \$30,000,000 less in Gross Income Tax. These companies would not be able to deduct the net gain, or \$3,400,000 from their adjusted tax base (see Step 2 above), resulting in a maximum annual state increase of \$153,000 in SNIT revenue (\$3,400,000 x 4.5%).

*Net impact:* The table below summarizes the net impact based on 1997 data for life, property, and casualty insurance premiums upon full implementation of the Insurance Premium Tax rate reduction from 2.0% to 1.3%:

Scenario	(1) No Gross Payers Switch	(2) All Pay Premium Tax
Affected Tax:	Change	Change
Insurance Premium Tax	(\$20,800,000)	\$7,500,000
Corporate Gross Income Tax	\$0	(\$30,000,000)
Supplemental Net Income Tax	\$72,000	\$153,000
<b>NET IMPACT</b>	<b>(\$20,728,000)</b>	<b>(\$22,347,000)</b>

The projected impact of this bill would be between a \$20.7 M and a \$22.3 M decrease in state General Fund revenues. It must be noted that reducing the Premium Tax will reduce the cost of doing business in other states for Indiana's domestic insurance companies. The total benefit to these companies as a result of this reduction is not currently known, but is expected to be significant. If these companies remain and

prosper in Indiana or if new business is attracted to the state, corporate and personal income tax revenues could increase.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** (Revised) If a lower Premium Tax rate helps Indiana's domestic insurance companies expand, corporate and personal income tax collections could be increased, benefitting counties with local option income taxes.

If an insurance company relocated outside the state because of lower Premium Tax rates in other states relative to Indiana's 2.0% rate, local property tax burdens could be shifted to other taxpayers.

**State Agencies Affected:** Department of Revenue, Department of Insurance.

**Local Agencies Affected:**

**Information Sources:** Department of Revenue; Department of Insurance.